IN THE

Supreme Court of the United States

OCTOBER TERM, 1980

No. 79-1013

WILLIAM RUBIN,

Petitioner,

v.

UNITED STATES OF AMERICA,

Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Second Circuit

BRIEF FOR PETITIONER, WILLIAM RUBIN

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Question Presented

Whether a pledge of stock to a bank as collateral for a loan is a "sale" of a security under § 77q(a), Title 15, U.S.C. (Securities Act of 1933).

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Opinion Below

The opinion of the Court of Appeals is officially reported at 609 F.2d 51 (1979).

Jurisdiction

The Court of Appeals in a split decision affirmed the conviction. Timely petitions for rehearing and a suggestion for a hearing *en banc* were denied on November 20, 1979. By Order of the Court of Appeals previously issued on October 10, 1979, the Court of Appeals stayed the issuance of the mandate pursuant to Rule 41(a) of the Federal Rules of Appellate Procedure pending application to this Court for a writ of certiorari. The petition for a writ of certiorari was filed on December 19, 1979 and was granted on April 14, 1980. Jurisdiction of this Court rests on 28 U.S.C. § 1254(1).

Statutory Provisions

§ 2(3), Securities Act of 1933, § 3(a)(13), (14), Securities Exchange Act of 1934, §§ 77q(a), 77x, Title 15, U.S.C., § 371, Title 18, U.S.C., have been set forth in the petition for the writ of certiorari at pages 3-4.

Title 15, United States Code

Sec. 79b(a)(23)

"'Sale' or 'sell' includes any sale, disposition by lease, exchange or pledge, or other disposition."

Title 18, United States Code

Sec. 1014

"Whoever knowingly makes any false statement or report, . . . for the purpose of influencing in any

way the action of . . . any bank the deposits of which are insured by the Federal Deposit Insurance Corporation, . . . upon any application, advance, discount, purchase, purchase agreement, repurchase agreement, commitment, or loan, or any change or extension of any of the same, by renewal, deferment of action or otherwise, or the acceptance, release, or substitution of security therefor, shall be fined not more than $5,000 or imprisoned not more than two years, or both."

Securities Exchange Act of 1934

Sec. 10(b)

"To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

Code of Federal Regulations, Vol. 17, § 240.10b-5

Rule 10b-5

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

"in connection with the purchase or sale of any security."

Statement of the Case

Petitioner was indicted on January 27, 1978 in three counts. Count 1 charged a conspiracy under Section 371 of Title 18, U.S.C., to violate (a) Section 17(a) of the Securities Act of 1933 (77q(a) and 77x of Title 15, U.S.C.), (b) Section 77e of Title 15, U.S.C., (c) Sections 1014 and 2 of Title 18, U.S.C., and (d) Sections 1341 and 1343 of Title 18, U.S.C. Counts 2 and 3 charged violations of Sections 1014 and 2 of Title 18, U.S.C., and violations of Sections 77q(a) and 77x of Title 15, U.S.C., respectively.

The part of the conspiracy which is at issue here is that which charged a violation of Sections (17(a), 77q(a) and 77x, Title 15, U.S.C.). As part of the objects and means whereby that part of the conspiracy was committed, the indictment charged that the fraud in obtaining loans from the Bankers Trust Company occurred by pledging as collateral to said bank common stock of All-State Insurance Company, Satellite Systems Corp., General Investment Corp. and Marlin International Company.

Rubin is 48 years old, having been born in New York. He graduated from New York University in 1951. He at-

tended the New York Law School at night and graduated in 1960. Rubin was neither admitted to the Bar nor did he practice law. In 1956 he became a CPA. Rubin formed his own accounting firm in 1975 and has conducted it since then as a senior partner of W. R. Rubin & Co. (R.* 1638-1639). Between 1961 and 1970 Rubin was with the accounting firm of Fred Landau & Co. (R. 1776). He left Landau & Co. and the accounting business in 1970 to form his own firm specializing in mergers and acquisitions (R. 1777, 1781-1782). In September or October, 1971, he accepted employment with North American Planning Corp., a public brokerage company in which he was a business consultant and a member of the board of directors (R. 1787).

When North American began to have financial difficulty, he sought additional financial help from others which led him to co-defendant Leonard James, who was a former Internal Revenue agent and who Rubin knew had been previously employed by Dugan's Bakery, a former client of Landau & Company (R. 1798). Through James some financial help was obtained (R. 1799) as well as an introduction to co-defendant Deaton with whom James was then in the coal and energy business as Tri-State Energy Company (R. 1803). To Rubin, Deaton alleged himself to be an expert on coal and gas, a forecaster of the shortage of energy, a man who had apparently been in the pipeline business for many years, and a bright, articulate, and charming individual (R. 1803-1804).

When North American was taken over by a trustee in August or September of 1972 on application of the SEC, Rubin left the company to go with Tri-State Energy.

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* The letter "R" followed by a number designates page references to the trial transcript.

Deaton and James had told Rubin that Tri-State's prospects were tremendous and the profits dealing in coal and gas substantial (R. 1836-1837). While he was told Tri-State had a cash flow problem, he was further told discussions with others were being had which would bring in millions to Tri-State (R. 1837-1838). Although Rubin was told he would make money with them, Deaton refused to give him a stock interest in the business which was owned, he said, 50-50 by James and him (JA178*; R. 1838). Rubin agreed to go with the company and as compensation to receive $2,000 a month, a $10,000 Christmas bonus (R. 1837), and 20% of the profits (R. 1838, 1841).

Because Tri-State needed capital Rubin approached the Bankers Trust Company with whom he had had excellent relations while with Landau & Co. and with whom he had negotiated loans in behalf of clients of Landau. Rubin had met Raymond Ludwig of that bank and sought from him on October 19, 1972 for Tri-State a $5,000,000 loan which the company needed to operate the mine (R. 1855). Ludwig declined the loan of that size (R. 1855). Instead Ludwig said:

> "I am going to put you on for $50,000 for 30 days. At the end of the 30 days, if you can produce an up-to-date financial, we . . . will see your track record." (R. 1859)

Ludwig introduced petitioner and Deaton to his assistant John Keating on that day. Keating was a prosecution witness. He was told the bank was making a loan to Tri-State Energy which was in the coal business with mines in Kentucky and which needed the loan for payroll at the mine (JA6; R. 222, 224). Keating was further instructed

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* The letters "JA" followed by a number designates page reference to the joint appendix.

by Ludwig to open checking accounts and process the loan as he would do normally with any new account (R. 222). The documents obtained were the execution of a promissory note for $50,000 (JA6-7, 122), a Tri-State corporate resolution authorizing the execution of the promissory note, the opening of a bank account, the execution of the signature cards, the right to borrow money, and the individual guarantees of the loan by Rubin and co-defendants Deaton and James (JA6-7; R. 227). None of the documents executed by the borrower on that day or any subsequent day specifically dealt with collateralizing the loan. Keating said Ludwig told him on October 19, 1972 that "we would be receiving collateral on the loan" (JA8). A certificate for 400,000 shares of American Leisure Corporation common stock bearing a legend that the stock was restricted was received at the bank from the borrower on October 20, 1972 (*id*). A financial statement of the borrower containing a balance sheet dated October 20, 1972 (JA39-40; GX 49, B-2c) was subsequently given to Keating on October 27, 1972 (JA40-41). The statement reflected the borrower's net worth as $7,100,000. Besides the financial statement the bank received in late October or early November, 1972 a written three month projection of the borrower's prospective income (JA40-41; GX 49, A-19). The projection plotted gross income of $540,000 based on purported spot sales of coal to Continental Coal Corporation and Repoca Resources, as well as a long term contract with Roland Werkstatten, a German company (JA42). The bank considered this projection the single most "significant document" it received from the borrower because it was from this information that the bank could determine how the loan repayments were to be made:

> "A. [Keating] Document A-19 is a projection that was prepared by Mr. Rubin and delivered to me by Mr. Rubin.
>
> * * *

Q. About when did he deliver it to you?

A. It was sometime after the initial loan was made, October, late October, early November 1972.

Q. Did you have any discussions with him concerning it?

A. Yes. This was the—as far as I was concerned, this was one of the most important documents that I had received from the company. What it did is it gave me an analysis of when the company was going to generate cash from the sale of coal and how much was going to be generated and when the—what the cash would be used for and what the net figure or net cash flow of the company was so that that could be used to retire any bank loans that had been made.

Now, the document indicates that sales would be made of $120,000 in December 1972, 240 in January of 1973, and 180 in February of 1973.

Now, the sales that are associated with this were $300,000 from a Continental Coal Corporation and $240,000 from Repoca Resources." (JA42)

An additional three months loan of $50,000 was made on November 20, 1972 (JA15, 128). The original one month loan of $50,000 was extended for three months on November 22, 1972 (JA16, 130). A further loan of $100,000 was made on November 30, 1972 (JA18, 132) and on December 6, 1972 a further loan was made of $275,000 (JA20, 134). The total lent was the sum of $475,000. Additional collateral was received by the bank after October 20, 1972. 2,000 shares of All-State Life Insurance Company was received by the bank on November 10, 1972 (JA66, 168). 100,000 shares of Management Dynamics, Inc. was received December 6, 1972, but was returned by the bank to the borrower for 175,000 shares of General

Investment stock and received by the bank on December 19, 1972, 50,000 shares of stock of Satellite Systems Corporation was received on January 19, 1973, and 20,000 shares of Marlin Investment stock was received on January 30, 1973 (JA66, 168). The additional loans by the bank between November 20 and December 6 were made after the borrower's three month gross income projection was received by the bank, said Keating, and it was that projection which was "taken into account in making these further loans" (JA71).

In describing the nature of these loans Keating referred to a bank record, that is, an "offering ticket" (JA9) which reflected interest on the loan, the type of loan, and a notation "lien stock 400,000 shares American Leisure Corp." which he said was given as collateral for the loan (JA10). Lien stock, Keating stated, is in bank jargon "side collateral". "Side collateral" was defined in the following colloquy between Keating and the prosecutor

> "Q. Now, when you said 'side collateral,' can you tell us what you mean by that?
>
> A. Well, when the loan was made initially, the loan was envisioned that it would be repaid from the ongoing operations of the corporation, namely from the sale of coal or natural gas. The collateral was taken as a secondary source of repayment in the event that the primary source, the ongoing operations of the corporation didn't materialize." (JA10-11)

On February 26, 1973 despite the fact that the loans totalling $475,000 had matured and had not been paid, the bank, believing the loans would nevertheless be paid, requested the borrower to execute a demand note for

$475,000 covering the previous loans made between October 20 and December 6 (JA58, 139). Although the stock collateral was still held by the bank the demand note executed by the borrower, said Keating, was "a yellow form associated with an unsecured loan, although this particular loan was not. The reason that that note was utilized rather than a secured note form was because we believed the primary source of repayment was going to come from the operations of the coal mine and the gas fields and the collateral that was taken at that time was in what we call side collateral or lien collateral, and that was basically under a security agreement which was given to us in connection with the loans." (JA67).

Two days later after receiving an inquiry from the Justice Department about the borrower (JA59-60), the bank on March 5, 1973 demanded payment of the loan (JA60). The loan was not paid. The bank did not foreclose or attempt to sell the collateral. Instead it instituted a suit in the Supreme Court, County and State of New York (JA88, 175). Petitioner signed a confession of judgment for over half a million dollars with interest and attorneys fees added (JA120, 175).

Summary of Argument

To construe the definitional terms of "sale" and "purchase" in the anti-fraud provisions of the Securities Acts of 1933 and 1934 as including a pledge of stock as collateral for a commercial loan "would add a gloss to the operative language of the statute quite different from its commonly accepted meaning", as this Court noted in *Ernst & Ernst* v. *Hochfelder,* 425 U.S. 185, 199, 96 S.Ct.

1375, 1383 (1976). "Sale" and "purchase" are ordinary, commonly understood words which involve a transfer of title or ownership from one person to another. A pledge as collateral for a loan is a deposit of personal property as security with an implied or express power of sale upon default. The legislative history of the anti-trust provisions of the Securities Acts of 1933 and 1934 defining "sale" and "purchase" reveals no trace of any Congressional intent to regulate transactions involving a pledge of securities. As this Court has often stated:

> "When Congress wished to provide a remedy to those who neither purchased nor sold securities it had little trouble in doing so expressly." *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 734, 95 S.Ct. 1917, 1925 (1975).

Because one of the remedial purposes of the Securities Acts was to protect investors from the type of fraudulent conduct that may have existed in the instant case does not justify extending the scope of the anti-fraud provisions of the Securities Acts beyond Congressional intent and beyond the common meaning of the terms "sale" and "purchase". This Court as late as the end of this Term said in *Aaron* v. *SEC,* No. 79-66, 48 U.S.L.W. 4609, 4613 (decided June 2, 1980):

> "Though cognizant that 'Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes,"' *Affiliated Ute Citizens* v. *United States, supra,* at 151, quoting, *SEC* v. *Capital Gains Research Bureau, supra,* at 195, the Court has also noted that 'generalized references to the "remedial purposes"' of the securities laws 'will not justify

> reading a provision "more broadly than its language and statutory scheme reasonably permit."' *Touche Ross & Co.* v. *Redington,* 442 U.S. 560, 578, quoting, *SEC* v. *Sloan,* 436 U.S. 103, 116. Thus, if the language of a provision of the securities laws is sufficiently clear in its context and not at odds with the legislative history, it is unnecessary 'to examine the additional considerations of "policy" . . . that may have influenced the lawmakers in their formulation of the statute.' *Ernst & Ernst* v. *Hochfelder, supra,* at 214, n. 33."

The interests and liabilities created by pledge transactions involving ordinary commercial loans are regulated by state law. Adequate remedy exists under said laws to protect those interests without burdening the federal courts with unnecessary and unwarranted criminal or civil actions. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. *supra* at 741.

For these reasons the decisions of the Fifth and Seventh Circuits in *National Bank of Commerce of Dallas* v. *All American Assurance Company, et al.,* 583 F.2d 1295, 1298 (5th Cir. 1978), and *Lincoln National Bank* v. *Herber,* 604 F.2d 1038, 1040 (7th Cir. 1979), that a mere pledge of stock for an ordinary commercial loan is not a "sale" or "purchase" within the anti-fraud provisions of the 1933 and 1934 Acts are a proper reflection of this Court's opinions and the Congressional intention. The opinions of the Courts of Appeals for the Second and Sixth Circuits in *United States* v. *Gentile,* 530 F.2d 461 (2d Cir. 1976), cert. den., 426 U.S. 936 (1976), *Mallis* v. *Federal Deposit Insurance Corp.,* 568 F.2d 824 (2d Cir. 1977) cert. granted, 431 U.S. 928, 97 S.Ct. 2630, 53 L.Ed.2d 243, cert. dismissed, *sub nom Bankers Trust Co.* v. *Mallis,* 435 U.S. 381, 98 S.Ct. 1117, 55 L.Ed.2d 357 (1978), and *Mans-*

bach v. *Prescott, Ball & Turben,* 598 F.2d 1017 (6th Cir. 1979), which are to the contrary, should not be supported.

For these reasons the judgment of the Court of Appeals should be reversed.

POINT I

The pledge of securities as collateral for a loan is neither a "sale" nor a "purchase" for the purpose of invoking the anti-fraud provisions of the Securities Acts.

The Court of Appeals below held without addressing the issue before this Court that

> "We have examined each of the other points raised by Rubin and find them to be without merit." 609 F.2d supra, at 66

Presumably that conclusion was based upon the Court of Appeals prior decision in *United States* v. *Gentile,* 530 F.2d 461 (2d Cir. 1976), cert. den., 426 U.S. 936 (1976), a decision relied upon by the District Court in its holding that a pledge of securities by Tri-State Energy, Inc. for the loan from the Bankers Trust Company was as a matter of law a "sale" within the meaning of § 77q(a), Title 15, U.S.C. (R. 2669). *Gentile* was a decision urged by the prosecutor as having "plainly reached the correct result . . .", and, the prosecutor added, was equally supported by the Court of Appeals decision in *Mallis* (Gov't brief in the Court of Appeals, pp. 79-80).

In *Gentile,* the Court of Appeals held that a pledge was within the literal definition of a "sale" under § 2(3), 15 U.S.C. § 77(b)(3) of the Securities Act of 1933, and that there is no requirement that title pass to con-

stitute a "sale" within the meaning of the statute. 530 F.2d *supra* at 466. In *Mallis,* a civil action for fraud under Section 10(b) and Rule 10b-5 of the Securities Exchange Act of 1934, the Court of Appeals held:

> "We believe that the rationale underlying our holding in *Gentile* with respect to Sections 2(3) and 17(a) of the 1933 Act is persuasive authority for holding that a pledge constitutes a 'contract to sell or otherwise dispose of' a security within the meaning of Section 3(14) of the 1934 Act. Accordingly, on the facts of this case, we hold that both a 'sale' and a 'purchase' may be cognizable under Section 10(b) of the 1934 Act. Appellants were purchasers by virtue of their acceptance of the pledge by Arnold and Fowler; and Bankers Trust was a seller by virtue of its release of the Kateses' pledge." 568 F.2d *supra* at 820.

Gentile expressly rejected the Court of Appeals' decision in *McClure* v. *First National Bank,* 497 F.2d 490 (5th Cir. 1974), cert. den. 420 U.S. 930 (1975) which had held:

> "[M]ere acceptance of a stock pledge as collateral in a privately negotiated transaction between borrower and lender does not, of itself, bring within the scope of the federal securities acts a transaction otherwise outside their purview."

The term "sale" is defined in the Securities Act of 1933, ¶ 2(3), 15 U.S.C. § 77b(3), to include "every contract of sale or disposition of a security or interest in a security, for value." The 1934 Act defines a "sale" to include "any contract to sell or otherwise dispose of", and defines the words "buy" or "purchase" to include "any contract to buy, purchase, or otherwise acquire." §§ 3(a)(13) and (14),

15 USC § 78c(13) and (14). While the issue in this case involves a charge of conspiracy to violate, among other objects, § 77q(a), Title 15, U.S.C. (1933 Act) in committing a fraud in the "sale" of a security, it does not appear that Congress in enacting a similar anti-fraud provision under the 1934 Securities Act intended to alter the 1933 Act definition of "sale" even though there does exist a slight difference in wording. As the Court of Appeals noted in *National Bank of Commerce of Dallas* v. *All American Assurance Company, et al.,* 583 F.2d 1295, 1298 (5th Cir. 1978):

> "Although there are slight differences in wording between the 1933 Securities Act and the 1934 Securities Exchange Act, the definitions of these terms are functionally equivalent and are for the purposes of this case so treated. [Cases cited]."

Neither the Securities and Exchange Commission nor the other courts of appeals who are in conflict on whether a pledge is a "sale" or a "purchase" under the anti-fraud provisions of the Securities Acts of 1933 or 1934 take issue with that conclusion of the Court of Appeals in *National Bank of Commerce of Dallas* v. *All American Assurance Company, supra.* See, for example, brief of the Commission, amicus curiae, on the merits (pp. 12-13) submitted in *Bankers Trust Company* v. *Mallis,* 431 U.S. 928, 97 S.Ct. 2630, 53 L.Ed.2d 243, dismissed 435 U.S. 381, 98 S.Ct. 1117, 55 L.Ed.2d 357 (1978). We believe this proposition has further support in the fact that the 1933 and 1934 Acts were passed by the same Congress and should be considered together as this Court noted in *Tscherepnin* v. *Knight,* 389 U.S. 332, 342, 88 S.Ct. 548, 19 L.Ed.2d 564 (1967).

We further submit that the holdings in *Gentile* and *Mallis,* and later in *Mansbach* v. *Prescott, Ball & Turben,*

incorrectly construe the definitions of "sale" and "purchase" in the 1933 and 1934 Acts to include a pledge of stock as collateral for a loan.

The legislative history of the provisions defining "sale" and "purchase" reveals no trace of any Congressional intent to regulate transactions involving a pledge of securities as collateral for a commercial loan from a bank. As this Court stated in *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. 723, 734, 95 S.Ct. 1917, 1925, 44 L.Ed.2d 539:

> "When Congress wished to provide a remedy to those who neither purchased nor sold securities, it had little trouble in doing so expressly."

Congress could obviously have said so, as it did in the Public Utility Holding Company Act of 1935. There Congress provided that " 'sale' or 'sell' includes any sale, disposition by lease, exchange or pledge, or other disposition." § 79b(a)(23), Title 15, U.S.C. That Act like the Securities Acts of 1933 and 1934 contained anti-fraud provisions. § 79*l*(d), Title 15, U.S.C.

The meaning of the words "sale" and "purchase" under the Securities Acts of 1933 and 1934 held in *Gentile* and *Mallis* to include a pledge of stock as collateral for a commercial loan, we submit, "would add a gloss to the operative language of the statute quite different from its commonly accepted meaning." *Ernst & Ernst* v. *Hochfelder, supra.* In *Blue Chip Stamps* v. *Manor Drug Stores, supra,* this Court also stated that an act of Congress which defines a word of long usage should be interpreted to have intended its "long established legal meaning" in the absence of "unmistakeable support in the history and structure of the legislation." 421 U.S. *supra* at 756, 95 S.Ct. *supra* at 1917 (Con. Op. of Mr. Justice Powell). "Sale"

and "purchase" are well-defined words of legal and commonly accepted meaning.

SALE: "Contract whereby the absolute, or general, ownership of property is transferred from one person to another for a price, or sum of money, or, loosely, for any consideration." Webster's Third New International Dictionary (1964).

PURCHASE: (1) . . . (2) ACQUISITION . . .; the acquiring of title to or property in anything for a price: a buying for money or its equivalent (the number of shares in a business)." Webster's Third New International Dictionary (1964).

PLEDGE: 1. . . . b: a chattel or object of personal property delivered by a debtor or obligor to a creditor or obligee to be kept by the latter until the debt or obligation is satisfied: an object given as security by pledge c (1) a bailment or a chattel or object of personal property as security for the satisfaction of a debt or other obligation . . ." Webster's Third New International Dictionary (1964).

"Sale" and "purchase" in both common and ordinary understanding mean the acquisition and disposition of ownership.

> "At common law a pledge would be readily distinguishable from a sale since a pledge involves a transfer of possession only, not of title." *Lincoln National Bank* v. *Herber,* 604 F.2d 1038, 1040 (7th Cir. 1979).

See, *Pauly* v. *State Loan & Trust Co.*, 165 U.S. 606, 17 S.Ct. 465 (1897) (State Loan & Trust Co. pledgee of stock of California Nat'l Bank held as collateral for a loan, is not an owner of the pldeged stock liable under a federal statute holding a shareholder of California Nat'l Bank responsible for its debts).

It is equally well-established that a pledge of stock as collateral for a loan is not a "sale" or "purchase". Ownership rights remain with the pledgor while the interest the pledgee obtains is merely the security interest that entitles the pledgee to sell the stock on default. To characterize the pledgor as a "seller" and the pledgee as a "purchaser" of the pledged security is, we submit, to pervert the ordinary and commonly understood relationship between the two. A pledge is a "deposit of personal property as security with an implied power of sale upon default." L. Jones, Collateral Securities and Pledges, § 1 (3d ed. 1912); Restatement of Security, § 1 (1941)

> "One does not normally speak of the 'purchase' or 'sale' of a loan . . ." *SEC* v. *Fifth Ave. Coach Lines,* 289 F.Supp. 3, 38 (S.D.N.Y. 1970), aff'd, 435 F.2d 510 (2d Cir. 1970).

The differences between these terms were appropriately described in *National Bank of Commerce of Dallas* v. *All American Assurance Company, supra*:

> "The rights and privileges of the parties are not affected by a pledge in the same manner as by a 'sale' or 'purchase.' The pledgor generally (1) has the right to sell the stock subject to the security interest, (a) is entitled to vote the stock, (3) has the right to receive all dividends, and (4) continues to be liable for ad valorem taxes.

See generally, L. Jones, Collateral Securities and Pledges §§ 1, 176a, 441, 602 (3d ed. 1912).

"The pledgee, on the other hand, has 'no general property right in the thing pledged, but only a right upon default, to sell in satisfaction of the pledgor's obligation.' *Pauly* v. *State Loan & Trust Co.,* 165 U.S. 606, 622, 17 S.Ct. 465, 471, 41 L.Ed. 844 (1897). The pledgee does not participate in any appreciation of the stock, has none of the rights normally accorded shareholders, and has no right to sell the collateral for its own account. Indeed, its relationship is of a fiduciary character, *Easton* v. *German-American Bank,* 127 U.S. 532, 437, 8 S.Ct. 1297, 32 L.Ed. 210 (1888), and it must account for all proceeds in excess of the debt and profits accruing as a result of possession of the collateral. Restatement of Security ¶ 27 (1941)." (583 F.2d *supra* at 1300).

Both Courts of Appeals in *National Bank of Commerce of Dallas* v. *All American Assurance Company, supra,* and *Lincoln National Bank* v. *Herber, supra,* recognized that the statutory definition of "sale" which under the 1933 Act includes "every . . . disposition of a security or interest in a security, for value" and the or "otherwise dispose" or "otherwise acquire" of the language of the 1934 Act was broad enough to include a pledge transaction. However, both Courts of Appeals, correctly we submit, rejected such a "literal approach" to the definitions in the Acts as was done in *Gentile* and *Mallis* because such a "literal approach" was contrary to the ordinary and common understanding of a pledge of stock given as collateral for a loan. Both Courts of Appeals adopted and followed the reasoning of this Court in rejecting a "literal" application of the securi-

ties laws in favor of an analysis looking to underlying economic realities. See *United Housing Foundation, Inc.* v. *Forman,* 421 U.S. 837, 849, 95 S.Ct. 2051, 44 L.Ed.2d 621 (1975) ("Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction . . ."); *Tscherepnin* v. *Knight,* 389 U.S. 332, 88 S.Ct. 548, 553 (1967) ("[I]n searching for the meaning and scope of the word 'security' in the Act[s], form should be disregarded for substance and the emphasis should be on economic reality.").

Bankers Trust Company lent $450,000 to Tri-State upon promissory notes collateralized by a pledge of stock certificates at the time the loans were issued. There can be no suggestion that the form of this transaction between Bankers Trust Company and Tri-State Energy, Inc. did not represent the substance of the matter. Indeed, the "reality" of the instant transaction is that the Bankers Trust Company simply lent money to Tri-State Energy primarily because of its belief in the solvency of that company and the ability of that company to generate sufficient income to repay the loan on maturity. The pledge of the stock as collateral was merely a secondary source for the bank in the event there was a default of the loan. This is abundantly clear from the testimony of Keating from the Bankers Trust Company who said:

> "[W]hen the loan was made initially, the loan was envisioned that it would be repaid from the ongoing operations of the corporation, namely from the sale of coal or natural gas. The collateral was taken as a secondary source of repayment in the event that the primary source, the ongoing operations of the corporation didn't materialize." (JA10-11).

In sum, the pledge of stock as security for the loan with the Bankers Trust Company was in fact and common usage a garden variety pledge and not a "sale" or "purchase". Common accepted meaning and long-established legal definition, as well as established canons of statutory construction, support the correctness of the views of the Courts of Appeals in *National Bank of Commerce of Dallas* and *Lincoln National Bank* that a mere pledge of stock as security for a loan is not within the definitions of "sale" or "purchase" under the 1933 and 1934 Securities Acts.

POINT II

Sound policy reasons indicate that Congress never intended to extend the anti-fraud provisions to pledge transactions.

This Court has frequently had occasion to note that the fundamental purpose of the Securities Acts was to protect investors against false and deceptive practices that might injure them. *Affiliated Ute Citizens* v. *United States,* 406 U.S. 128, 151, 92 S.Ct. 1456, 1470, 31 L.Ed.2d 741, 760 (1972); *Superintendent of Insurance* v. *Bankers Life & Casualty Co.,* 404 U.S. 6, 11-12, 92 S.Ct. 165, 168, 30 L.Ed.2d 128, 134 (1971); *J. I. Case Co.* v. *Borak,* 377 U.S. 426, 432-433, 84 S.Ct. 1555, 1559-1560, 12 L.Ed.2d 423, 427-428 (1964). Bankers Trust Company by virtue of its acceptance of the pledge of certificates of stock from Tri-State Energy neither made an investment in the pledged securities nor did the bank by its mere acceptance of the pledge affect the securities industry as suggested in *Gentile.* Bankers Trust Company looked to the pledged collateral as a "secondary source of repay-

ment in the event that the primary source, the ongoing operations of the corporation, did not materialize." (JA10-11). Bankers Trust Company did not accept the pledged stock for distribution or for any other purpose except the traditional purpose of securing the loan.

As Professor Loss has stated:

> "Federal legislation was hardly needed for privately negotiated pledge transactions between borrowers and lenders." (L. Loss, Securities Reg. 649 (2d ed. 1961)).

Gentile, we submit, expanded the meaning of "sale" beyond what Congress intended and what was necessary to effect the remedial purposes of the 1933 Act. *Mallis,* we submit, did the same thing with respect to Section 10(b) of the 1934 Act. As the Court of Appeals noted in *National Bank of Commerce of Dallas, Gentile* predicated its holding upon its statement:

> "The pledgee takes a legally enforceable interest in the pledged securities which he assumes will compensate for any default on the underlying loan. The pledgee thereby decreases the risk that he will suffer loss due to nonpayment of the loan. In effect, the pledgee assumes a very real investment risk that the pledged securities will have continuing value, a risk that is identical in nature to the risk taken by investors which serves as the indisputable basis for statutory regulation of securities transactions." (530 F.2d *supra* at 467).

The Court of Appeals in *National Bank of Commerce of Dallas* correctly responded that:

> "This rationale might be a persuasive argument that the federal securities laws ought to encom-

> pass pledges, as well as purchases and sales. It does little to support a decision that they in fact do cover pledges. Congress can be presumed to know the difference between a collateral pledge transaction and a sale and purchase. If it had intended to cover both, it could have easily done so by words traditionally used to differentiate between the two." (583 F.2d *supra* at 1300).

Further criticism of this statement in *Gentile* was noted in *Lincoln National Bank* v. *Herber,* 604 F.2d *supra* at 1043:

> "[W]e disagree with this analysis. Risk there is, but the risk is not an *investment* risk. It is the ordinary *commercial* risk taken by any secured lender. The risk that the pledgor does not own the collateral he purports to own exists no matter what the nature of the collateral."

Bankers Trust Company did not make an investment in Tri-State stock. The bank did not accept the collateral for profit it might make on the stock pledged at the time the loans were made as it would if it was an investor. Cf. *United Housing Foundation* v. *Forman,* 421 U.S. *supra* at 851:

> "Common sense suggests that people who intend to acquire only a residential apartment in a state-subsidized cooperative, for their personal use, are not likely to believe that in reality they are purchasing investment securities simply because the transaction is evidenced by something called a share of stock. * * * In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit."

Similarly, the acceptance by the Bank of the pledged collateral was to secure the loan in the event of default; "it was not to invest for profit."

"A commercial bank's business is lending money, not trading in securities." *McClure* v. *First National Bank,* 497 F.2d *supra* at 495.

The absence of any Congressional intent to include a pledge transaction as a "sale" or "purchase" in the 1933 and 1934 Acts is further reflected in the fact that before the decision in *SEC* v. *Guild Films Co.,* 279 F.2d 485 (2d Cir. 1960), cert. den. 364 U.S. 819 (1960), on which the holdings in *Gentile* and *Mallis* are based, or at least shortly before the SEC's submission in *Guild Films,* the SEC did not publicly contend that a pledge of stock as collateral for a commercial loan was a "sale" or a "purchase" under the 1933 and 1934 Securities Acts (L. Loss, Securities Reg. 645 (2d ed. 1961)). The uncertain scope of the decision in *Guild Films* was so severely questioned that Judges in the District Court in the Southern District of New York declined to apply federal jurisdiction to such pledge transactions under the anti-fraud provisions of the Securities Acts. *Fox* v. *Glickman Corp.,* 253 F.Supp. 1005, 1011-1012 (S.D.N.Y. 1966); *Investment Properties Intl. Ltd.* v. *I.O.S. Ltd.* [1970-1971], F.Sec.L.Rep. (CCH) par. 93,011 (S.D.N.Y. 1971). Indeed, at the time of the instant loans from Bankers Trust Company in 1972, Rubin's conduct, even assuming it was fraudulent for purposes of this appeal, was not considered violative of Section 77q(a), Title 15, U.S.C., or Section 10(b) of the 1934 Act, criminally or civilly, because a pledge of stock as collateral for a loan had been held in the Southern District of New York not to be a "sale" or a "purchase" under the Securities Acts.

What *Gentile* suggests, we submit, is that the fraud in that case in which the banks made loans on pledged embezzled stock certificates warranted an extension of the statutory definitions of "sale" and "purchase" to embrace a pledged transaction. Merely because one of the remedial purposes of the Securities Acts was to protect investors from such type of fraudulent behavior as in *Gentile,* or as may have existed in the instant case, does not mean that the anti-fraud provisions should be stretched beyond what Congress intended and contrary to the common meaning of the words "sale" and "purchase" in order to cover such type of conduct. Indeed, in *Aaron* v. *SEC, supra,* this Court recently stated:

> "Though cognizant that 'Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed "not technically and restrictively, but flexibly to effectuate its remedial purposes,"' *Affiliated Ute Citizens* v. *United States, supra,* at 151, quoting, *SEC* v. *Capital Gains Research Bureau, supra,* at 195, the Court has also noted that 'generalized references to the "remedial purposes"' of the securities laws 'will not justify reading a provision "more broadly than its language and statutory scheme reasonably permit."' *Touche Ross & Co.* v. *Redington,* 442 U.S. 560, 578, quoting, *SEC* v. *Sloan,* 436 U.S. 103, 116." (48 U.S.L.W. *supra* at 4613)

Simply put, fraudulent representations as to the nature and value of the securities pledged for ordinary commercial loans are neither within Section 77q(a) of Title 15 U.S.C. (1933 Act) nor within Section 10(b) of the 1934 Act since a pledge of stock does not constitute a "sale" or a "purchase" of a security within the meaning of those statutes. When Congress needed to impose special defini-

tions upon common words in order to effectuate the remedial purposes of an act it had little trouble doing so. *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. *supra* at 734, 95 S.Ct. *supra* at 1925; *Public Utility Holding Company Act of 1935;* Section 79b(a)(23), Title 15, U.S.C.

There was, we submit, no need for Congress to extend Section 77q(a) of Title 15, U.S.C. (1933 Act) or Section 10(b) of Title 15, U.S.C. (1934 Act) to pledges in order to effectuate its anti-fraud purposes.* The parties to a pledge transaction are situated quite differently from purchasers and sellers of securities in terms of legal recourse under state law. The pledgee, unlike a securities purchaser, has a remedy on a promissory note against the maker and any guarantor. *National Bank of Commerce of Dallas* v. *All American Assurance Company,* 583 F.2d 1295, 1300 (5th Cir. 1978). Indeed, that is exactly what Bankers Trust Company did in the instant case. It sued the borrower and the guarantors on the promissory notes in the Supreme Court, County and State of New York, and obtained a confession of judgment from the petitioner (JA88, 175).

The Court of Appeals in *Lincoln National Bank* v. *Herber, supra,* appropriately stated:

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* Significantly, the securities fraud which was charged as an object of the conspiracy under § 77q(a), Title 15, U.S.C., together with the violation of § 1014, Title 18, U.S.C., was unnecessary since the fraudulent representation as to the pledged collateral was also considered by the prosecutor as part of the violation under § 1014. The prosecutor so advised the District Court as follows:

> "Ms. Neugarten: Count 2 subsumes all false statements as to collateral, not just Marlin but the five other securities, since 1014 specifically includes false statements as to collateral and substitution of collateral." (R. 2309)

> "The final consideration counselling against extension of the antifraud provisions of the 1933 and 1934 Acts to the situation where securities are fraudulently pledged as collateral for a bank loan is that state law already extensively occupies the field. This would be a further indication that Congress never intended to extend the antifraud provisions to pledge transactions as well as a sound policy reason not to extend the federal securities laws into this area, as there is no apparent need." (604 F.2d *supra* at 1044).

And further,

> "State regulation of a field and the availability of remedies under state law have both been considered by the Supreme Court in a number of recent decisions declining to imply a private right of action under various sections of the securities laws. *See, e.g., Santa Fe Industries, Inc.* v. *Green,* 430 U.S. 462, 97 S.Ct. 1292, 51 L.Ed.2d 480 (1977); *Piper* v. *Chris-Craft Industries, Inc.,* 430 U.S. 1, 97 S.Ct. 926, 51 L.Ed.2d 124 (1977); *Cort* v. *Ash,* 422 U.S. 66, 95 S.Ct. 2080, 45 L.Ed.2d 26 (1975)." (604 F.2d *supra* at 1044).

Relegating such conduct involved in a pledge transaction to the state courts is where such transactions belong since such security interests are adequately regulated by state laws. The inevitable consequences of extending the scope of Sections 77q(a) and 10(b) to pledge transactions would be to increase litigation in the federal courts without any increased protection to the parties. See *Blue Chip Stamps* v. *Manor Drug Stores,* 421 U.S. *supra* at 741.

CONCLUSION

The judgment of the Court of Appeals should be reversed.

Respectfully submitted,

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